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SUBJ: TURKEY'S AUTOMOTIVE SECTOR RUNNING ON EMPTY

Ref: ANKARA 118

¶1. (U) This is a joint Embassy Ankara/Consulate General Istanbul cable. This cable is sensitive but unclassified.

¶2. (SBU) Summary. Turkey's automotive sector is in desperate straits due to the collapse in European demand for automotive goods. For years, the sector has been a model of Turkey's export-oriented growth philosophy and, in 2008, it became Turkey's largest export sector (surpassing steel and textiles), with total exports of USD 18.3 billion (80% of Turkish automotive production). However, auto exports fell dramatically in late 2008, dropping -35.4% in the fourth quarter. This has continued into 2009, with January numbers showing a 64% YOY decrease. The sector's problems are having (and will continue to have) serious effects on the wider economy. Some 1.3 million people depend directly or indirectly on the sector for employment, and the GOT is understandably eager to avoid factory closures and layoffs (although these have already started, with over a thousand announced layoffs and more to come). Despite this desire, the GOT's policy response has so far been rather tepid, with a great deal of talk but little in the way of concrete assistance for the sector. The stimulus package passed on February 18 contains some limited measures to help the sector, and a new package focused on the automotive industry is expected "soon," but industry has been disappointed in the GOT response to date. Regardless of what the GOT does or fails to do, however, the sector will face troubled times until demand picks up again. End summary.

Turkey's Automotive Sector

¶3. (U) The automotive industry in Turkey began its rise immediately after the economic crisis in 2001, benefiting from Turkey's increased emphasis on export-oriented production. The industry saw rapid growth, jumping from 346,000 automobiles in 2002 to 1.1 million in 2007. Exports also grew rapidly, from 258,000 automobiles in 2002 to 820,000 in 2007, with a value of USD 12.2 billion. The sector's direct employment rose from 26,000 in 2002 to 47,500 in 2007. Support industries also grew rapidly, with the auto parts industry providing 200,000 jobs as of 2007, generating USD 30 billion in revenue, and exporting USD 2.8 billion worth of goods (again,

with 65% destined for European markets). In all, the Foreign Trade Undersecretariat estimates that the employment of 1.3 million people depends upon automotive production or related service industries. There are currently 15 manufacturing companies in the automotive sector, most with foreign capital. There are 4,000 auto parts producers, 185 of them with foreign capital. Turkey is the largest producer of buses in Europe, and the third largest producer of light commercial vehicles.

2008: A Bright Beginning Foiled by the Crisis

¶4. (SBU) During the first half of 2008, the automotive sector was on track for a record year. Both domestic and foreign sales were up 25-30% on the year and production was going to come in well above the targeted 1.3 million units. According to Dr. Ercan Tezer, Secretary General of the Automotive Industry Association (OSD), this began to change toward the end of the second quarter. At that time, the number of new vehicle orders began falling fast, led by falling demand in Europe (Note: Approximately 80% of Turkey's automotive production is exported, of which 70% is destined for Europe. As a result, Turkey's auto sector is extremely sensitive to demand trends in Europe. End note.) The OSD began advising its members to consider cutting back on production to avoid an inventory overhang, but their warning was largely ignored both by industry and the GOT, which was eager to see continued growth (and increasing tax revenues) in this profitable sector.

Industry's reluctance to cut back meant that production soon began to outpace demand, and industry is now sitting on 150-160,000 unsold vehicles (12% of annual production).

¶5. (SBU) Vural Kural, Head of the Turkish Sector Assemblies and Economic Research Department at the Union of Chambers and Commodities Exchanges of Turkey (TOBB), painted a similar gloomy picture. Up until April 2008, the automotive sector was operating at full capacity, but it began to slow in May and June before plummeting 14.3% YOY and 32.1% YOY in July and August, respectively. By January 2009, automotive capacity utilization was 53.2% lower than the previous January. The falloff in units produced was even more dramatic, with a 63.4% YOY decline in December 2008, bringing the sector back to its 2004 level (Note: The discrepancy between production and capacity utilization is due to a decrease in overall capacity as factories began to shutter in late 2008. End note.) Exports also fell sharply, ending December down 49.4% from the previous year (although overall value increased for the year, due to the strong first quarter).

¶6. (U) Faced with low demand and overproduction, the industry has reacted by temporarily shutting down production lines. Ford Otosan, one of Turkey's largest producers, announced in November that it would be shutting down production at two factories on five separate dates spread out over the following four months. Other producers immediately followed suit. On February 16, Ford announced that it would be stopping production entirely February 26-March 15 and again March 27-31, citing deteriorating market conditions. Following layoffs of 300 people in December, Ford now employs 6200 people but noted that it will have to reexamine its employment plan in light of expected reductions in production. In January, Turkey's largest automobile producer Tofas (a partner of Italian Fiat) laid off 800 workers and Componenta, a Finnish automotive casting firm, let

425 workers go. Kural stated that until the pending inventory of 160,000 vehicles is sold off, production will be more or less halted indefinitely.

The GOT Response (Or Lack Thereof)

¶7. (SBU) Tezer noted that by late September 2008, it had become obvious that the crisis, now in full swing, was having a deeply negative effect and the industry asked the GOT to implement a set of measures to help the sector. Industry representatives met with Deputy PM Nazim Ekren, Finance Minister Kemal Unakitan, Trasury Minister Mehmet Simsek, Foreign Trade Minister Kursad Tuzmen, and one other minister that Tezer declined to name (later confirmed to be Industry Minister Zafer Caglayan). For two months, Tezer said, these negotiations went nowhere. Then the GOT regained interest, and a series of proposals were considered, including:

-- Credit incentives for domestic consumers, including a reduction in the 15% tax on automotive loans (60% of domestic auto purchases are financed through credit);

-- Incentives for continued R&D investment;

-- Funds and/or tax incentives to keep the workforce in place and prevent layoffs; and

-- An incentive plan for investment, with the possibility of substantial corporate tax reductions depending on the size and location of the investment.

In addition to the above proposals, ideas began to circulate in the press for other incentives, such as: reduced electricity costs, tax breaks for purchasing environmentally-friendly vehicles, and the reinstitution of a tax break for new car

purchasers who trade in older vehicles (see reftel).

¶8. (SBU) On February 18, Parliament approved a broad package of measures to stimulate the economy, some of which will benefit the automotive sector. Specifically for the auto sector, the GOT announced an amnesty for fines and unpaid taxes on vehicles older than 30 years. This is intended to encourage the owners of old vehicles to sell their cars and buy new ones. The anticipated tax discount on new cars was not a part of the package, however. (Comment: It seems unlikely someone so poor that they are driving a 30-year-old car is going to be enticed into buying a new vehicle simply because they receive an amnesty from taxes and fines they probably had no intention of paying anyway. End comment.) The package also contained broader measures not limited to the automotive sector - these will be reported on septel.

¶9. (SBU) While Tezer welcomed the limited measures in the new package, he was disappointed that it included neither retail credit incentives nor large-scale corporate tax incentives sought by industry. Industry Minister Zafer Caglayan, in what has become a weekly ritual, has repeatedly told the press that targeted sectoral relief packages will be coming "soon," and Tezer expressed his hope that later GOT efforts will incorporate more of the industry's ideas in this sectoral package. Deputy PM Ekren announced on February 20 that the sectoral packages will cover the textile, iron and steel, contracting,

automotive, tourism and maritime sectors, including financing assistance and tax remedies. He also added that Turkey's Eximbank would increase its loan capabilities from USD 500 million to USD 1 billion as part of the same package.

¶10. (SBU) Kural observed that the GOT is "showing different faces to different people" in an attempt to assure the G20, IMF, and local actors that their sometimes conflicting concerns will all be addressed. As a result, its policy response has been chaotic. He also noted that he would like to see more in the way of broad tax relief as a way to immediately address the pressures on corporations and to prevent further layoffs within the automotive sector, but lamented that most of what he had seen in the rumored sectoral packages involved encouraging new investment spending. He criticized the GOT for failing to assess the problem correctly, saying that their policies rest on the assumption that demand will return to "normal" (i.e. pre-crisis levels) in the relatively short term and that investment spending will therefore pay immediate dividends. The idea that the crisis has introduced a fundamental shift in the world economy - with an end to soaring demand fueled by easy credit and a shift to higher savings rates - is not one that appeals to the GOT, Kural contended, because it would require accepting that they need to adjust policies for a longer-term approach.

Protectionism Redux

¶11. (SBU) Trade protectionism has a long history in Turkey, but it has been held in abeyance since 2001 as exports led the economy's impressive growth. Now that growth has slowed, however, protectionist tendencies are again beginning to surface. Tezer complained that 70% of domestic auto purchases are imported, and bemoaned the lack of import protections to help local producers, as he alleged exist in South Korea and Japan. He also observed that the 80% of production that is exported is "too high" and expressed hope for a 60/40 export/local consumption mix in the future, observing that local profit margins are higher and that stronger domestic demand for domestically-produced autos would help cushion the sector against future shocks. He expressed his hope that Ankara would use policy measures to encourage local sales of domestically-produced vehicles, such as through the retail credit

incentives.

Comment

¶12. (SBU) Given the importance of the automotive and automotive parts industries to Turkey's economy and the relatively high wages in the sector, any slowdown will have serious knock-on effects in the larger economy as well as on government finances. The GOT likely will pass a sectoral package to help the sector, but the breadth of tax cuts that the industry seems to expect will be difficult for a government that is already struggling to match declining tax revenues with its spending plans. The automotive sector stimulus plan may help marginally to ease the pain but, until demand recovers, more production halts and layoffs are likely to come. End comment.